Supreme Court, U.S.
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In The

# Supreme Court of the United States

W.C. LUSARDI,

*Petitioner,*

vs.

40235 WASHINGTON STREET CORPORATION,
a California corporation,

*Respondent.*

**On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit**

## PETITION FOR WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

1. Whether 11 U.S.C. § 549(c)[1] – which, in effect, validates an otherwise void transfer of property in violation of a bankruptcy stay if made to a *bona fide purchaser* for "present fair equivalent value" – is an exception to the automatic stay statute of the Bankruptcy Code (11 U.S.C. § 362(a)[2])?

2. If 11 U.S.C. § 549(c) is available to afford Petitioner relief in this case, whether "present fair equivalent value" is the price, in fact, received at a forced (tax) sale under this Court's decision in *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994)?

3. Whether the tax sale conducted by local authorities in violation of a bankruptcy stay (11 U.S.C. § 362(a)) was *void* or merely *voidable*?

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[1] The full text of statute is set forth at App. 49-50.

[2] See full text of statute at App. 50-51.

## STATEMENT OF PARTIES PURSUANT TO RULE 29.6

W.C. LUSARDI is an individual.

40235 WASHINGTON STREET CORPORATION (Washington Street) is a California corporation. Washington Street is not a governmental party, has no parent corporation and is not a publicly-owned company nor does any publicly-owned company own any portion of Washington Street's stock.

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## PETITION FOR WRIT OF CERTIORARI

Petitioner respectfully petitions the Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

## OPINIONS BELOW

The district court's opinion (per Rhodes, D.J.) granting declaratory relief and quieting title to the subject property is published at *40235 Washington Street Corp. v. Lusardi*, 177 F. Supp. 2d 1090 (S.D. Cal. 2001). The court of appeals' decision (per Reinhardt, J., joined by Pregerson, J. and Archer, J.[3]) affirming the district court's ruling, is published at *40235 Washington Street Corp. v. Lusardi*, 329 F.3d 1076 (9th Cir. 2003). The order denying rehearing *en banc* is attached as part of the appendix, but is not otherwise published.

An earlier decision in the same case is reported at *40235 Washington Street Corp. v. Lusardi*, 976 F.2d 587 (1992).[4]

[3] Senior Circuit Judge Glenn L. Archer, Jr. of the United States Court of Appeals for the Federal Circuit, sitting by designation.

[4] Where certiorari is timely sought from the most recent court of appeals judgment in the case, the Court has authority to consider questions determined in earlier appeals in the case. *Major League Baseball Players Assn. v. Garvey*, 532 U.S. 504, 508 fn. 1 (2001).

## STATEMENT OF JURISDICTION

The court of appeals entered its decision on May 23, 2003, and denied rehearing *en banc* on July 9, 2003.

Petitioner invokes this Court's jurisdiction under 28 U.S.C. § 1254(1).

## STATUTORY PROVISIONS INVOLVED

The following provisions of the Bankruptcy Act are reprinted in the appendix: 11 U.S.C. § 362 and 11 U.S.C. § 549 (see Appendices).

## STATEMENT OF THE CASE

W.C. Lusardi (Lusardi) purchased an apartment complex at a Riverside County tax foreclosure auction in 1990. Unbeknownst to Lusardi, the owner of the property, 40235 Washington Street Corporation ("Washington") had recently filed a federal bankruptcy petition, creating an automatic stay preventing the sale.

The County's tax sale violated the bankruptcy stay and was therefore (according to the Ninth Circuit) void. Although it is undisputed Lusardi was unaware of Washington's bankruptcy at the time of the sale and Washington's bankruptcy petition was later dismissed as filed in bad faith, Lusardi never acquired possession or any benefit of ownership. Neither has his money been returned to him by Riverside County.

The parties have been litigating for more than a dozen years, in both state and federal court.

In 1991, Washington Street sued Lusardi in district court, arguing that the sale to Lusardi was void because it had occurred in violation of the automatic stay provision of 11 U.S.C. § 362(a).

Lusardi moved to dismiss this case, arguing that the tax sale was only voidable, not void. Relying on the Ninth Circuit Bankruptcy Appellate Panel's decision in *In re Schwartz*, 119 B.R. 207 (9th Cir. BAP 1990), the district court held the sale had not been voided, and dismissed Washington Street's case. Washington Street appealed the district court's rulings.

While Washington Street's appeal was pending, the Ninth Circuit overruled the Bankruptcy Appellate Panel's *Schwartz* decision, holding that violations of the automatic stay are void, not voidable. See *Schwartz v. United States (In re Schwartz)*, 954 F.2d 569, 574 (9th Cir. 1992). When the Ninth Circuit decided Washington Street's appeal, it determined the dismissal of Washington Street's case was wrong, and vacated the dismissal order. See *40235 Washington Street Corp. v. Lusardi*, 976 F.2d 587 (9th Cir. 1992). The underlying case therefore proceeded on the assumption the tax sale was void *ab initio*. See *40235 Washington Street Corp. v. Lusardi*, 177 F. Supp. 2d 1090, 1095-1096 (S.D. Cal. 2001).

On remand, Lusardi asked the district court to quiet title in his favor on the ground that section 549(c) of the federal Bankruptcy Code, 11 U.S.C. § 549(c), provides an exception to the automatic stay provision and is applicable to him as a good faith purchaser without knowledge of the bankruptcy petition. Lusardi argued that under this Court's decision in *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), the purchase price he paid at the tax sale

*under competitive bidding* (i.e., $267,500) was the "present fair equivalent value" of the property.[5]

The district court rejected Lusardi's argument, finding Lusardi had not paid anything near the property's "fair market value" (i.e., estimated at $600,000). In defining "present fair equivalent value" as something close to the "fair market value" of the property, the district court specifically declined to extend this Court's analysis in *BFP* to 11 U.S.C. § 549(c). *40235 Washington Street Corp. v. Lusardi*, 177 F. Supp. 2d 1090, 1101 (S.D. Cal. 2001). The district court offered the following justifications for its decision:

> (1) The Court's *BFP* decision was "narrowly crafted" to mortgage foreclosures under section 548;
>
> (2) Sections 549(c) and 548 contain different language by which Congress presumably intended to create different "benchmarks";
>
> (3) Because the disruption of states' interests caused by section 549(c) is "different" than the disruption attendant to section 548, section 549(c) could be interpreted to require a close-to-fair-market benchmark yields without causing

[5] In *BFP v. Resolution Trust Corp.*, 511 U.S. 531, a majority of the Court, *per* Justice Scalia, held "that a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with." *Id.* at 545. After the *BFP* decision, most of the Circuits held "present fair equivalent value" *ought not* be measured against the property's "fair market value" in *any* forced sale context. See *In re Stone*, 72 F.3d 466, 470 (5th Cir. 1995).

any additional disruption to areas of state regulation. *Id.* at 1101-1102.

In its review of the district court's judgment, the Ninth Circuit did not reach the issue of whether the question of whether this Court's decision in *BFP* should be applied to Section 549(c). Instead, the court of appeals affirmed the district court's grant of relief to Washington for another reason which had been expressly rejected by the district court.[6] The Ninth Circuit concluded "section 549(c) does not create an exception to section 362(a)."

According to the Ninth Circuit, "Section 549 concerns the ability of a bankruptcy trustee to avoid post-petition transfers of the property of the estate, and subsection (c) protects bona fide purchasers who did not know of the petition and who meet certain other requirements." The Ninth Circuit found the language of the statute was clear, and only allowed "avoidance actions by the trustee, not transfers that are already void under the automatic stay." Based on its belief "section 549(c) does not create an exception to the automatic stay provision," the court concluded the relief provided by the statute was not available to Lusardi.

In so ruling, the Ninth Circuit specifically recognized its decision conflicts with prior cases decided by the Third, Fifth and Ninth Circuits holding, that section 549(c) *does* create an exception to section 362(a). See, e.g., *In re Siciliano*, 13 F.3d 748, 751, fn. 2 (3d Cir. 1994); *Sikes v. Global Marine, Inc.*, 881 F.2d 176, 179 (5th Cir. 1989);

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[6] The district court expressly found "section 549(c) of the Bankruptcy Code creates an exception to the automatic stay provision."

*Schwartz v. United States*, 954 F.2d 569, 575 (9th Cir. 1992); *Thompson v. Margen* (*In re McConville*), 110 F.3d 47, 49 (9th Cir. 1997); *Tsafaroff v. Taylor* (*In re Taylor*), 884 F.2d 478, 483-484 (9th Cir. 1989); *Phoenix Bond & Indemnity Co. v. Shamblin* (*In re Shamblin*), 890 F.2d 123, 127 fn. 5 (9th Cir. 1989); *Walker v. California Mortgage Serv.* (*In re Walker*), 861 F.2d 597, 600 (9th Cir. 1988).[7]

The panel also acknowledged its holding conflicts with the view expressed in two bankruptcy treatises. See 3 COLLIER ON BANKRUPTCY ¶ 362.11[1] (15th ed rev. 2002); Norton, BANKRUPTCY LAW AND PRACTICE 2D § 59:5 (Supp. Nov. 2002).

Lusardi's Petition for Rehearing *en banc* was denied by the Ninth Circuit on July 9, 2003. (App. 46-47)

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[7] See also *Shaw v. County of San Bernardino* (*In re Shaw*), 157 B.R. 151 (9th Cir. BAP 1993); *Jones v. Wingo* (*In re Wingo*), 89 B.R. 54, 58 (9th Cir. BAP 1988); *In re Shah*, 2001 Bankr. LEXIS 380, *15-*26 (Bankr. E.D. Pa. 2001); *Carpio v. Smith* (*In re Carpio*), 213 B.R. 744, 750-51 (Bankr. W.D. Mo. 1997); *Groupe v. Hill* (*In re Hill*), 156 B.R. 998, 1007 (Bankr. N.D. Ill. 1993); *Little v. Bago* (*In re Bago*), 149 B.R. 610, 612 (Bankr. C.D. Cal. 1993); *In re King*, 35 B.R. 530, 531 (Bankr. N.D. Ga. 1983).

## REASONS FOR GRANTING CERTIORARI

### I.

### THE NINTH CIRCUIT'S DECISION CONFLICTS WITH ESTABLISHED PRECEDENT FROM OTHER CIRCUIT COURTS OF APPEALS ON THE QUESTION OF WHETHER SECTION 549(c) IS AN EXCEPTION TO THE BANKRUPTCY STAY.

The Ninth Circuit's decision in this case held, contrary to the district court, that "section 549(c) does not create an exception to section 362(a)." The Court of Appeals explained:

> . . . . [Lusardi] asserts that section 549(c) of the Code provides a further exception to the automatic stay provision. This assertion is plausible primarily because a number of courts, including ours on some occasions, have assumed it to be correct, as we discuss below. The district court in the present case relied on such assumptions and held that section 549(c) does create an exception to the automatic stay provision. . . .
>
> However, we have never before addressed the question directly. Recently the Bankruptcy Appellate Panel of the Ninth Circuit did so and concluded in an opinion we find persuasive that section 549(c) does not create an exception to section 362(a). *Value T Sales, Inc. v. Mitchell* (*In re Mitchell*), 279 B.R. 839, 841-44 (B.A.P. 9th Cir. 2002). We reach the same conclusion as the Bankruptcy Appellate Panel. [Footnote omitted.]

In so ruling, the Ninth Circuit recognized the plethora of contrary authority within its own circuit, and in other federal circuit courts of appeals:

As noted above, some of our prior decisions imply, contrary to our present holding, that section 549(c) does create an exception to the automatic stay provision. Most recently, in *Schwartz* [*v. United States*, 954 F.2d 569, 575 (9th Cir. 1992)], we stated at one point in the opinion that "subsection 549(c)'s protection of good faith purchasers carves out an extremely specific and narrow exception to the automatic stay when section 362 overlaps subsection 549(c)." *Schwartz*, 954 F.2d at 574. . . .

. . . In another case, we assumed that section 549(c) creates an exception to the automatic stay but held that the requirements of section 549(c) were not met. *Walker v. California Mortgage Serv.* (*In re Walker*), 861 F.2d 597, 600 (9th Cir. 1988) (perfection requirement not met). Similarly, we made the same assumption but decided the issue on a different basis in *Thompson v. Margen* (*In re McConville*), 110 F.3d 47, 49 (9th Cir. 1997) (applying section 364(c)(2)). Finally, to confuse matters even further, in *Phoenix Bond & Indemnity Co. v. Shamblin* (*In re Shamblin*), 890 F.2d 123, 127 n.5 (9th Cir. 1989), we expressly declined to "resolve [the] difficult question" whether the section 549 exception applies when an automatic stay is in effect.

* * *

We also note that the Third and Fifth Circuits and, in a pre-*Mitchell* decision, the Bankruptcy Appellate Panel of the Ninth Circuit, have stated in dictum, and a number of Bankruptcy Courts have held, assumed, or opined, contrary to our holding today, that section 549(c) does create an exception to section 362(a). See, e.g., *In re Siciliano*, 13 F.3d 748, 751 n.2 (3d Cir. 1994); *Sikes v.*

> *Global Marine, Inc.*, 881 F.2d 176, 179 (5th Cir. 1989); *Shaw v. County of San Bernardino* (*In re Shaw*), 157 B.R. 151 (B.A.P. 9th Cir. 1993). . . .

The Ninth Circuit's opinion also acknowledged that the holding of the case

> . . . conflicts with the view expressed in two bankruptcy treatises, [COLLIER ON BANKRUPTCY and NORTON BANKRUPTCY LAW AND PRACTICE 2D]. . . . We also note that in *Tsafaroff v. Taylor* (*In re Taylor*), 884 F.2d 478 (9th Cir. 1989), we assumed Collier to be correct, without considering the question, and affirmed a decision of the Bankruptcy Appellate Panel holding that the lack-of-notice requirement of 549(c) was met. *Id.* at 483-84. . . .

One of the primary purposes of certiorari review is to bring about uniformity of decisions on matters of federal law between the circuit courts of appeals and/or between a circuit court of appeals and a decision of this Court. See *Brown Transport Corp. v. Atcon, Inc.*, 439 U.S. 1014, 1017 (1978) [WHITE, J., dissenting]. Where (as here) the circuit court of appeals' decision on an important federal question conflicts with established authority in other federal circuit courts of appeals, certiorari is appropriate to resolve the conflict. Rules of the Supreme Court of the United States, rule 10(a).

## II.

## THE DISTRICT COURT'S DECISION CONFLICTS WITH THIS COURT'S DECISION IN *BFP* AND THE DECISIONS OF OTHER CIRCUIT COURTS OF APPEALS APPLYING THE REASONING OF *BFP* TO CLAIMS UNDER SECTION 549(c).

As noted above, the district court (Rhoades, DJ, S.D. Cal.) quieted title to the subject property in *Washington Street* by declining to extend this Court's analysis in *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994) to the facts of this case. 177 F. Supp. 2d 1090, 1101 (S.D. Cal. 2001). In so ruling the district court concluded: (1) the Court's *BFP* decision was "narrowly crafted" to mortgage foreclosures under section 548; (2) 11 U.S.C. §§ 548 and 549(c) contain different language by which Congress presumably intended to create different "benchmarks"; and (3) because the disruption of states' interests in section 549(c) is "different" than that discussed by the Court with regard to section 548, there is no additional disruption to areas of state regulation if section 549(c) is interpreted to require a close-to-fair-market benchmark yields. *Id.* at 1101-1102.

The district court's decision highlights another conflict among the circuit courts of appeals regarding the application of 11 U.S.C. § 549(c).

In *In re Stone,* 72 F.3d 466 (5th Cir. 1995), the Fifth Circuit applied this Court's reasoning in *BFP v. Resoultion Trust*, supra, to Section 549(c). The Fifth Circuit recognized that in some circumstances "reasonably equivalent present value" and "present fair equivalent value" might have been intended to mean "something different." *Id.* at 470. The Fifth Circuit was "unable, however, to perceive a

meaningful difference between 'reasonably' and 'present fair' as applied ***in the forced sale context***." *Id.*[8]

The Fifth Circuit therefore concluded "the logic of *BFP* trumps the differences between the relevant language of Section 548(a)(2)(A) *and* Section 549(c) and the contexts of mortgage foreclosure sales and tax sales." *Id.*

> In . . . the context of a forced sale, (1) Section 549(c)'s requirement of "present fair equivalent value" ought not be measured against the property's "fair market value"; and (2) given the State's essential interest in maintaining clear titles to real property, we should not attempt to ascertain the substantive content of "present fair equivalent value." *Id.* at 472.

More recently, in *In re McDonald*, 210 B.R. 648 (Bankr. S.D. Fla. 1997), the issue before the bankruptcy court was whether the successful bidders at a post-petition foreclosure sale purchased the debtor's property for "present fair equivalent value" pursuant to section 549(c). *Id.* at 651. After discussing this Court's decision in *BFP v. Resolution Trust Corp.*, the bankruptcy court noted:

> In *Matter of T.F. Stone Co.*, the Fifth Circuit addressed whether the Supreme Court's holding in *BFP* could be extended to section 549(c) of the Bankruptcy Code. The Fifth Circuit found that, despite the slight variation in the wording of the

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[8] On this point, the Fifth Circuit noted a conflict with "*In re Shaw*, 157 B.R. 151[, 153-154] (9th Cir. BAP 1993), in which the bankruptcy court held that the different language in § 549(c) compelled closer adherence to fair market value than the language of § 548." *Id.* at 472, fn. 4.

> two Code sections, it was proper to extend *BFP* and hold that section 549(c)'s requirement of "present fair equivalent value" could be satisfied by either forced tax sale or mortgage foreclosure sale of the property.
>
> This Court agrees and holds that the price received at a foreclosure sale conducted in compliance with state law yields the present fair equivalent value of real property for purposes of section 549(c) of the Bankruptcy Code. Accordingly, the transfer of the property to the successful bidders was for its *present fair equivalent value* within the meaning of 11 U.S.C. § 549(c). *Id.* [footnotes and citations omitted].

Likewise, in *In re Fulmer-Vaught*, 218 B.R. 56 (Bankr. W.D. Mo. 1998), the bankruptcy court said:

> In *BFP v. Resolution Trust Corp.*, the Court indicated that a "reasonably equivalent value" was deemed to have been paid when a regularly conducted, without collusion, foreclosure was held. Granted, reasonable equivalent value is not the same as fair market value, and of course we are talking about Section 549 in the instant case whereas the Supreme Court was considering Section 548 in the *BFP* case. Nevertheless, I think the Court's decision in *BFP* is certainly indicative of the weight to be given to a regularly conducted foreclosure where the holder of the note is not the purchaser. *Id.* at 58.

Most recently, in *In re Shah*, 2001 Bankr. LEXIS 380, the bankruptcy court also found the logic of *Stone* and *BFP* persuasive.

> The market value of . . . a piece of property is the price which it might be expected to bring if

> offered for sale in a fair market; not the price which might be obtained on a sale at public auction or a sale forced by the necessities of the owner, but such a price as would be fixed by negotiation and mutual agreement, after ample time to find a purchaser, as between a vendor who is willing (but not compelled) to sell and a purchaser who desires to buy but is not compelled to take the particular . . . piece of property." . . . In short, "fair market value" presumes market conditions that, by definition, simply do not obtain in the context of a forced sale. . . . Market value cannot be the criterion of equivalence in the foreclosure-sale context. *Id.* at *33-*34 [citations omitted].

However, not all courts have embraced this Court's ruling in *BFP* as the definition of "present fair equivalent value."

In *In re Alphonso*, 211 B.R. 508 (E.D. Pa. 1997), a bankruptcy judge declined "to extend the narrow holding in BFP beyond mortgage foreclosures to include tax foreclosure sales." *Id.* at 518.

Likewise, in *In re Powers*, 88 B.R. 294, 297 (D. Nev. 1988), the bankruptcy judge addressed the question of whether a third party purchaser paid "present fair equivalent value" for the property at a foreclosure sale. The judge compared the term to a similar phrase found in 11 U.S.C. § 548(a)(2) [i.e., "reasonably equivalent value"]. However, based on the assumption that the use of different language signaled a different Congressional intent, the bankruptcy court decided "'fair equivalent value' connotes a more stringent standard than does 'reasonably equivalent value.'" *Id.* By way of explanation, the bankruptcy judge remarked:

> "'Reasonably equivalent' suggests a standard that tolerates a greater deviation from fair market value than does 'present fair equivalent.' The latter term . . . tolerates very little deviation from fair market value." *Id.*

In *In re Shaw*, 157 B.R. 151 (9th Cir. BAP 1993), a Bankruptcy Appellate Panel of the Ninth Circuit was called upon to define "present fair equivalent value." Citing *Powers*, the panel noted the differences in the language in Sections 548 and 549 suggested different results. Without much discussion, the panel concluded Congress must have intended a stricter meaning for "present fair equivalent value." *Id.* at 153-154.

## III.

## THE NINTH CIRCUIT'S DECISION CONFLICTS WITH PRECEDENT FROM OTHER CIRCUIT COURTS OF APPEALS ON THE QUESTION OF WHETHER A TRANSFER IN VIOLATION OF THE BANKRUPTCY STAY IS VOID OR VOIDABLE.

As noted above, Washington Street initiated the underlying action based on allegations that the County's tax sale was *void* because it had occurred in violation of the automatic stay provision of 11 U.S.C. § 362(a). The district court dismissed the case, finding the tax sale was only voidable.

While this case was on appeal, the Ninth Circuit decided *In re Schwartz*, 954 F.2d 569, 574 (9th Cir. 1992), in which it held violations of the automatic stay are void, not voidable. When the Ninth Circuit decided Washington Street's appeal, it vacated the district court's dismissal

order based on the *Schwartz* decision. See *40235 Washington Street Corp. v. Lusardi*, 976 F.2d 587 (9th Cir. 1992). Thereafter, the underlying case proceeded on the assumption the tax sale was void *ab initio*. See *40235 Washington Street Corp. v. Lusardi*, 177 F. Supp. 2d 1090, 1095-1096 (S.D. Cal. 2001).

As acknowledged by the court of appeals in *Soares v. Brockton Credit Union* (*In re Soares*), 107 F.3d 969 (1st Cir. 1997):

> The circuits are split on whether actions taken in derogation of the automatic stay are merely "voidable" or, more accurately, "void." Some courts characterize unauthorized post-petition proceedings as "voidable." See, e.g., *Jones v. Garcia* (*In re Jones*), 63 F.3d 411, 412 & n.3 (5th Cir. 1995), cert. denied, 134 L. Ed. 2d 666 (1996); *Bronson v. United States*, 46 F.3d 1573, 1578-1579 (Fed. Cir. 1995); *Easley v. Pettibone Mich. Corp.*, 990 F.2d 905, 911 (6th Cir. 1993).
>
> Other courts – a majority, insofar as we can tell – call such actions "void," but recognize that equitable considerations may alter some outcomes. See, e.g., *In re Siciliano*, 13 F.3d 748, 751 (3d Cir. 1994); *In re Schwartz*, 954 F.2d 569, 571 (9th Cir. 1992); *ICC v. Holmes Transp., Inc.*, 931 F.2d 984, 987-988 (1st Cir. 1991); *Job v. Calder* (*In re Calder*), 907 F.2d 953, 956 (10th Cir. 1990) (per curiam); *48th St. Steakhouse, Inc. v. Rockefeller Group, Inc.* (*In re 48th St. Steakhouse, Inc.*), 835 F.2d 427, 431 (2d Cir. 1987), cert. denied, 485 U.S. 1035 (1989); *Albany Partners Ltd. v. Westbrook* (*In re Albany Partners, Ltd.*), 749 F.2d 670, 675 (11th Cir. 1984). *Id.* at 976.

To summarize, "the Federal Circuit and Fifth Circuit have ruled that violations of the automatic stay are voidable, while the First, Second, Third, Seventh, Ninth, Tenth and Eleventh Circuits have ruled that violations of the automatic stay are void." *United States v. Washington International Ins. Co.*, 177 F. Supp. 2d 1313, 1323 fn. 11 (U.S Ct. of Interntl. Trade 2001).

If the Court grants certiorari in this case, it will also have an opportunity to address the conflict between the circuit courts of appeals on this crucial issue.

## CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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40235 WASHINGTON STREET CORPORATION, a California corporation, Plaintiff-Appellee, v. W. C. LUSARDI, an individual, Defendant-Appellant.
40235 WASHINGTON STREET CORPORATION, a California corporation, Plaintiff-Appellant, v. W. C. LUSARDI, an individual, Defendant-Appellee.

No. 01-56644, No. 01-56801

**UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT**

329 F.3d 1076

Appeal from the United States District Court for the Southern District of California. D.C. No. CV-90-01472-JSR D.C. No. CV-90-01472-JSR. John S. Rhoades, District Judge, Presiding

Argued and Submitted
February 4, 2003 – Pasadena, California

Filed May 23, 2003

Before: Harry Pregerson, Stephen Reinhardt, and Glenn L. Archer, Jr.*

**COUNSEL**

David A. Niddrie, Niddrie & Hegemier, LLP, for W.C. Lusardi.

Duane S. Horning, Mary A. Lehman, and James W. Huston, Gray Cary Ware & Friedenrich, LLP, for 40235 Washington Street Corporation.

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* The Honorable Glenn L. Archer, Jr., Senior Circuit Judge, United States Court of Appeals for the Federal Circuit, sitting by designation.

## OPINION

REINHARDT, Circuit Judge:

W.C. Lusardi purchased an apartment complex at a Riverside County tax foreclosure auction in 1990. Unbeknownst to Lusardi, the owner of the property, 40235 Washington Street Corporation ("WSC" or "the corporation") had recently filed a federal bankruptcy petition, creating an automatic stay preventing the sale. The sale was therefore void, and, although the bankruptcy petition was later dismissed, Lusardi never acquired possession or any benefit of ownership. Neither has his money been returned to him by Riverside County. The parties have been litigating for more than a dozen years, in both state and federal court. This appeal arises from the district court's order quieting title and granting declaratory relief in favor of WSC and denying relief to Lusardi. We affirm, although not on the same ground as that relied on by the district court.

### I. Background

WSC was incorporated on February 20, 1990. Eight days later it purchased an apartment complex in Palm Desert, California, located on a property that was in tax default and was scheduled to be sold at a Riverside County tax auction. The next day it filed a Chapter 11 bankruptcy petition, thereby creating, under section 362(a) of the federal Bankruptcy Code, an automatic stay on sales of properties it owned. 11 U.S.C. § 362(a). Although WSC informed the tax collector of its bankruptcy filing, Riverside County proceeded with the sale in violation of the stay. Lusardi, unaware of the bankruptcy petition, purchased the property at the foreclosure sale for $269,500.

The foreclosure sale included competitive bidding and complied with state law. After the tax sale, the bankruptcy court dismissed WSC's bankruptcy petition, finding that it was filed in bad faith. *In re 40235 Washington St. Corp.*, No. 90-01612-LM11 (Bankr. S.D. Cal. filed May 15, 1990). WSC retained, and continues to retain, possession of the property, and Riverside County has never returned Lusardi's money.

The litigation that followed, in both state and federal court, is described in the most recent decision of the district court, *see 40235 Washington St. Corp. v. Lusardi,* 177 F. Supp. 2d 1090, 1095-96 (S.D. Cal. 2001) and, in greater detail, in a 1998 order of the district court, *see 40235 Washington St. Corp. v. Lusardi,* No. 90-1472-R, unpublished order at 1-6 (S.D. Cal. filed August 19, 1998). A brief description of the federal litigation is all that is required here.[1]

The federal proceedings were initiated by WSC, which sought to quiet title and to obtain declaratory relief. It contended that because of the automatic stay Lusardi never acquired any title to the property. The proceedings in federal court were stayed pending the outcome of the state court litigation. *See 40235 Washington St. Corp. v. Lusardi,* 976 F.2d 587 (9th Cir. 1992). In 1998, the district court granted a motion by Lusardi to lift the stay on the federal litigation, and allowed Lusardi to bring counterclaims under federal and state law. Lusardi asked the

[1] Certain details of the state court litigation are relevant to WSC's arguments that Lusardi's claims for relief are both time-barred and barred by collateral estoppel. However, because we affirm the district court's denial of relief on other grounds, we do not reach those issues.

court to quiet title in his favor on the ground that section 549(c) of the federal Bankruptcy Code, 11 U.S.C. § 549(c), provides an exception to the automatic stay provision and is applicable to him as a good faith purchaser without knowledge of the bankruptcy petition. Alternatively, he demanded compensation from WSC for his lost investment and associated costs, under section 3728 of the California Revenue and Taxation Code. *Lusardi,* 177 F. Supp. 2d at 1096.

Ultimately, the district court granted WSC's motion for declaratory relief and to quiet title and denied all relief to Lusardi. 177 F. Supp. 2d at 1090. It agreed with Lusardi that section 549(c) of the Bankruptcy Code creates an exception to the automatic stay provision, *40235 Washington St. Corp. v. Lusardi,* No. 90-1472-R, unpublished order at 9-12 (S.D. Cal. filed Jan. 19, 1999), but held that Lusardi's purchase did not meet the requirements for invoking the exception. *Lusardi,* 177 F. Supp. 2d at 1096-102. The district court further held that the state tax law provisions under which Lusardi seeks compensation are preempted by the federal Bankruptcy Code. 177 F. Supp. 2d at 1102-05. Lusardi appeals the district court's grant of relief to WSC, including its quiet title order, while WSC argues that there is no federal jurisdiction. Although we hold, contrary to the district court, that section 549(c) of the Bankruptcy Code does not create an exception to the automatic stay provision, we affirm its grant of relief to WSC for the reasons set forth below.

## II. Discussion

### A. Jurisdiction

Federal courts have jurisdiction over matters in which a federal question is presented on the face of the well-pleaded complaint. *Abada v. Charles Schwab & Co., Inc.*, 300 F.3d 1112, 1118 (9th Cir. 2002). "Where the plaintiff seeks coercive relief under state law, as in a quiet title action, a well-pleaded complaint presents a federal question if the plaintiff's right to such relief 'necessarily turn[s] on some construction of federal law.'" *Yokeno v. Mafnas*, 973 F.2d 803, 807 (9th Cir. 1992) (quoting *Franchise Tax Bd. v. Const. Laborers Vacation Trust*, 463 U.S. 1, 9, 77 L. Ed. 2d 420, 103 S. Ct. 2841 (1983)). In the case before us, it would be impossible to quiet title in favor of either party without addressing the federal Bankruptcy Code issue discussed below. Furthermore, the Bankruptcy Code issue is not raised as a defense or merely in anticipation of avoiding a defense. *See Yokeno*, 973 F.2d at 807. Rather, the automatic stay provision, which was raised by WSC in its complaint, is the only basis on which WSC's claim to title could be superior to that of Lusardi. Therefore, there is federal jurisdiction.

### B. Stay Exception

Section 362(a) of the Bankruptcy Code provides that the filing of a bankruptcy petition creates an automatic "stay, applicable to all entities, of," inter alia, "any act to create, perfect, or enforce any lien against property of the estate." 11 U.S.C. § 362(a). Transfers in violation of the automatic stay are void. *Schwartz v. United States (In re Schwartz)*, 954 F.2d 569, 575 (9th Cir. 1992). When WSC filed its bankruptcy petition, the automatic stay took

effect, with the result that the Riverside County tax sale, conducted to enforce the tax lien on the property, was void. Unless an exception to section 362(a) applies, therefore, Lusardi's purchase of the property at the tax sale was without effect.

Eighteen exceptions to section 362(a) are listed in section 362(b). 11 U.S.C. § 362(b) (listing circumstances in which "the filing of a petition . . . does not operate as a stay"). The text of section 362(a) makes reference to the exceptions listed in section 362(b), 11 U.S.C. § 362(a) (providing that the stay applies "[e]xcept as provided in subsection (b) of this section"), but not to any other exceptions. The language of section 362, thus, suggests that the 18 listed exceptions are the only exceptions to the automatic stay.

Lusardi does not argue that any of the 18 exceptions of section 362(b) applies to his purchase. Rather, he asserts that section 549(c) of the Code provides a further exception to the automatic stay provision. This assertion is plausible primarily because a number of courts, including ours on some occasions, have assumed it to be correct, as we discuss below. The district court in the present case relied on such assumptions and held that section 549(c) does create an exception to the automatic stay provision. *Lusardi,* No. 90-1472-R, unpublished order at 9-12 (S.D. Cal. filed Jan. 19, 1999). However, we have never before addressed the question directly. Recently the Bankruptcy Appellate Panel of the Ninth Circuit did so and concluded in an opinion we find persuasive that section 549(c) does not create an exception to section 362(a). *Value T Sales,*

*Inc. v. Mitchell (In re Mitchell),* 279 B.R. 839, 841-44 (B.A.P. 9th Cir. 2002). We reach the same conclusion as the Bankruptcy Appellate Panel.[2]

Section 549 concerns the ability of a bankruptcy trustee to avoid postpetition transfers of the property of the estate, and subsection (c) protects bona fide purchasers who did not know of the petition and who meet certain other requirements. Section 549 provides in full as follows:

> § 549. Postpetition transaction
>
> (a) Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate –
>
> (1) that occurs after the commencement of the case; and
>
> (2)(A) that is authorized only under section 303(f) or 542(c) or that is authorized only under section 303(f) or 542(c) of this title; or
>
> (B) that is not authorized under this title or by the court.
>
> (b) In an involuntary case, the trustee may not avoid under subsection (a) of this section a transfer made after the commencement of such case but before the order for relief to the extent any

[2] Although the bankruptcy court dismissed WSC's bankruptcy petition as having been filed in bad faith, the dismissal has no bearing on the issues before us. Lusardi asked the court to apply the dismissal retroactively so as to give effect to the tax sale. The parties disagree as to whether the bankruptcy court denied the motion or rather declined to address it. In either case, Lusardi does not now seek relief on the theory that the stay should be retroactively voided.

value, including services, but not including satisfaction or securing of a debt that arose before the commencement of the case, is given after the commencement of the case in exchange for such transfer, notwithstanding any notice or knowledge of the case that the transferee has.

(c) The trustee may not avoid under sub-section (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.

(d) An action or proceeding under this section may not be commenced after the earlier of –

(1) two years after the date of the transfer sought to be avoided; or

(2) the time the case is closed or dismissed.

11 U.S.C. § 549.

As subsection (a) and (d) make clear, section 549 concerns avoidance actions by the trustee, not transfers

that are already void under the automatic stay. Subsection (c), which Lusardi invokes, prevents such avoidance actions from succeeding against certain bona fide purchasers. By its terms, subsection (c) creates an exception only to subsection (a). 11 U.S.C. § 549(c) (describing transfers that "trustee may not avoid under subsection (a) of this section"). Thus, as the *Mitchell* court noted, the language and the structure of both section 362 and section 549 support the view that section 549(c) does not create an exception to the automatic stay provision.

This interpretation is also consistent with the purposes of the two sections. The purpose of the automatic stay is to protect debtors from their creditors while bankruptcy proceedings are underway. *Schwartz,* 954 F.2d at 571 ("[The stay] is designed to protect debtors from all collection efforts while they attempt to regain their financial footing."); *see* H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1978) ("The automatic stay is one of the fundamental debtor protections. . . . "). The purpose of section 549, in contrast, is to provide a just resolution when the debtor himself initiates an unauthorized postpetition transfer. The general rule in such situations is that the trustee is authorized to avoid the transfer in order to protect the creditors. *See* 11 U.S.C. § 549(a); *Schwartz,* 954 F.2d at 574 ("Section 549 exists as a protection for creditors against unauthorized debtor transfers of estate property."). Section 549(c) creates an exception to that rule to protect innocent purchasers whom the debtor has defrauded. 5 COLLIER ON BANKRUPTCY, § 549.06 (15th ed. rev. 2002). As sections 362 and 549 are designed to protect different parties, it is not surprising that an exception to one would not apply to the other. Congress evidently saw fit, as *Mitchell* discerned, "to afford greater protection to [bona

fide purchasers] who purchase from debtors than to those purchasing at sales violating the automatic stay." *Mitchell*, 279 B.R. at 843.

As noted above, some of our prior decisions imply, contrary to our present holding, that section 549(c) does create an exception to the automatic stay provision. Most recently, in *Schwartz*, we stated at one point in the opinion that "subsection 549(c)'s protection of good faith purchasers carves out an extremely specific and narrow exception to the automatic stay when section 362 overlaps subsection 549(c)." *Schwartz*, 954 F.2d at 574. This statement, although the district court in *Lusardi* believed it was binding, was a mere assumption that did not contribute to our resolution of any matter at issue in the case. The "sole issue" in *Schwartz* was whether transfers in violation of the automatic stay were void or merely voidable. *Id.* at 570-71. We held that they were void and addressed section 549(c) only to refute the argument that section 549(c), because it is an exception to section 362(a), demonstrates that violations of the stay are not void.[3] Our assumption

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[3] In truth, we did not explain clearly in *Schwartz* the argument based on section 549(c) that we were refuting. We wrote that "[i]t is disingenuous to argue that the general rule must be invalid simply because there is a narrow exception to the rule." *Schwartz*, 954 F.2d at 574. It appears, then, that one of the parties argued that violations of the stay cannot be void because violations that meet the requirements of section 549(c) are not void. However, that argument is without any logic, because violations that meet the requirements of section 549(c) are also not voidable. A better argument on basis of section 549(c) can be found in *Sikes v. Global Marine, Inc.*, 881 F.2d 176, 179 (5th Cir. 1989), which held, contrary to *Schwartz*, that transfers in violation of the stay are voidable, not void. *Id.*

We addressed section 549 as a whole in *Schwartz* in order to refute the following, more persuasive argument: A transaction can be both in

(Continued on following page)

that section 549(c) does create such an exception was, in this sense, actually in tension with our holding. Furthermore, in subsequent portions of the opinion, *Schwartz* appears to assume precisely the opposite of its initial assumption: It appears to state quite clearly that section 549(c) does not create an exception to the automatic stay. *See, e.g., id.* at 574 ("The law in this circuit is that violations of the automatic stay are void and that section 549 applies to transfers of property which are not voided by the stay."). We therefore draw no conclusion from *Schwartz* as to the relationship between sections 362(a) and 549(c). In another case, we assumed that section 549(c) creates an exception to the automatic stay but held that the requirements of section 549(c) were not met. *Walker v. California Mortgage Serv. (In re Walker),* 861 F.2d 597, 600 (9th Cir. 1988) (perfection requirement not met). Similarly, we made the same assumption but decided the issue on a different basis in *Thompson v. Margen (In re McConville),* 110 F.3d 47, 49 (9th Cir. 1997) (applying section 364(c)(2)). Finally, to confuse matters even further, in *Phoenix Bond & Indemnity Co. v. Shamblin (In re Shamblin),* 890 F.2d 123, 127 n. 5 (9th Cir. 1989), we expressly declined to "resolve [the] difficult question" whether the section 549 exception applies when an automatic stay is in effect.

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violation of the automatic stay and controlled by section 549; section 549 explicitly makes unauthorized postpetition transactions not void, but rather avoidable by the trustee; therefore, a holding that transactions in violation of the automatic stay are void would conflict with section 549. *Schwartz,* 954 F.2d at 573-74. We assumed the premises of this argument but rejected the conclusion. *Id.*

We also acknowledge that our holding today conflicts with the view expressed in two bankruptcy treatises, *see* 3 COLLIER ON BANKRUPTCY § 362.11 (15th ed. rev. 2002) ("Section 549(c) contains an important limitation of the principle that actions taken in violation of the stay are void, or at least voidable."); NORTON BANKRUPTCY LAW AND PRACTICE 2D § 59:5 (Supp. Nov. 2002) (stating that *Schwartz* "correctly" regarded section 549(c) as an exception to section 362(a)). We also note that in *Tsafaroff v. Taylor (In re Taylor),* 884 F.2d 478 (9th Cir. 1989), we assumed Collier to be correct, without considering the question, and affirmed a decision of the Bankruptcy Appellate Panel holding that the lack-of-notice requirement of 549(c) was met. *Id.* at 483-84. We did so only shortly before we announced, in the final amended opinion in *Shamblin,* that the question was an open one.

We also note that the Third and Fifth Circuits and, in a pre-*Mitchell* decision, the Bankruptcy Appellate Panel of the Ninth Circuit, have stated in dictum, and a number of Bankruptcy Courts have held, assumed, or opined, contrary to our holding today, that section 549(c) does create an exception to section 362(a). *See, e.g., In re Siciliano,* 13 F.3d 748, 751 n. 2 (3d. Cir. 1994); *Sikes v. Global Marine, Inc.,* 881 F.2d 176, 179 (5th Cir. 1989); *Shaw v. County of San Bernardino (In re Shaw),* 157 B.R. 151 (B.A.P. 9th Cir. 1993); *Jones v. Wingo (In re Wingo),* 89 B.R. 54, 58 (B.A.P. 9th Cir. 1988); *In re Shah,* 2001 Bankr. LEXIS 380, *15-*26 (Bankr. E.D. Pa. 2001); *Carpio v. Smith (In re Carpio),* 213 B.R. 744, 750-51 (Bankr. W.D. Mo. 1997); *Groupe v. Hill (In re Hill),* 156 B.R. 998, 1007 (Bankr. N.D. Ill. 1993); *Little v. Bago (In re Bago),* 149 B.R. 610, 612 (Bankr. C.D. Cal. 1993); *In re King,* 35 B.R. 530, 531 (Bankr. N.D. Ga. 1983).

None of these decisions, however, considered the textual, structural, and policy arguments we address above. Most were arrived at without any analysis at all. While numbers are on the side of finding section 549(c) to create an exception, the clear weight of judicial reasoning strongly supports the contrary view. Specifically, so far as we are aware, every court that has considered the governing legal factors has reached the conclusion we have, that section 549(c) does not create an exception to the automatic stay provision. *See Mitchell,* 279 B.R. at 841-44; *Glendenning v. Third Fed. Sav. (In re Glendenning),* 243 B.R. 629, 633-34 (Bankr. E.D. Pa. 2000); *Smith v. London (In re Smith),* 224 B.R. 44, 46-48 (Bankr. E.D. Mich. 1998); *New Orleans Airport Motel Assocs. v. Lee (In re Servico, Inc.),* 144 B.R. 933, 934-37 (Bankr. S.D. Fla. 1992).

Because we hold that section 549(c) does not create an exception to section 362(a), we do not reach the issue whether Lusardi's purchase at the Riverside County tax foreclosure sale met the requirements of section 549(c).

### C. Preemption

California state law provides that after a property has been sold in a tax foreclosure sale, the tax deed acquired by the purchaser may not be voided unless the former owner reimburses the purchaser "the amount of taxes, penalties and costs expended by him or her as determined by the court in pursuit of title to the property." Cal. Rev.

& Tax. Code § 3728(a).[4] "If the amount required to be paid . . . is not paid within . . . six months, the court shall order a new tax deed issued by the county tax collector to the

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[4] Section 3728 provides in full as follows:

§ 3728. Payments required to be made before voiding deed

Before holding any tax deed heretofore or hereafter given under this chapter or Chapter 8 (commencing with Section 3771), former Chapter 3 (commencing with Section 3475), former Chapter 4.3 (commencing with Section 3534), or former Sections 3897 and 3897d of the Political Code to be void, the court shall determine the correct amount of taxes, penalties and costs that should be paid upon redemption to discharge the tax and assessment liens of all taxing agencies and revenue districts had the purported tax sale not been held and the court shall order the former owner or other party in interest to pay that amount within six months as follows:

(a) To the purchaser, or his or her grantee or successor in interest, the amount of taxes, penalties and costs expended by him or her as determined by the court in pursuit of title to the property, and when the purchaser at that sale or the grantee in any deed for taxes or his or her grantee or successor in interest is in possession of that property in good faith and claiming the property under a tax deed, which is regular upon its face, and has made permanent improvements thereon, the court shall not make that decree until there has also been repaid to the purchaser or his or her grantee or successor in interest a sum, as determined by the court, equal to the amount by which the value of the property has been enhanced by those permanent improvements; and

(b) To the county tax collector, the balance, if any, of the correct amount as determined by the court that should be paid upon redemption, which shall be distributed by the county to the taxing agencies and revenue districts as redemption money.

If the amounts are not paid in accordance with the order the court shall not hold the tax deed void.

original grantee or his successor in interest as designated in the order." *Id.* § 3728.1. Lusardi asserts that these provisions prevent the federal courts from voiding his deed unless WSC pays him the full amount he paid to Riverside County at the tax sale, as well as the other costs he incurred in acquiring title. The district court held that section 3728 is preempted by the automatic stay provision of the Bankruptcy Code, 11 U.S.C. § 362(a). We agree.

Under the doctrine of "conflict preemption," preemption is implied where "compliance with both federal and state regulation is a physical impossibility." *Gade v. Nat'l Solid Wastes Mgmt. Ass'n,* 505 U.S. 88, 98, 120 L. Ed. 2d 73, 112 S. Ct. 2374 (1992) (internal quotation marks omitted).

Section 3728 requires that, before a tax deed is declared void, the court must determine the amount of taxes owed on the property and order the former owner to pay to the purchaser that portion of the taxes, penalties and costs that the purchaser expended in pursuit of the title. Cal. Rev. & Tax. Code § 3728. Next, the court must order that the former owner pay any taxes that it still owes on the property to the appropriate tax agencies. *Id.* If both payments are not made within six months, a new tax deed will issue to the purchaser. *Id.* § 3728.1.

As noted above in our discussion of the federal Bankruptcy Code issue, transfers in violation of an automatic stay under section 362(a) are void: The property interests remain the same as they would have been if no transfer had been attempted. *See Schwartz,* 954 F.2d at 571. Section 3728 conflicts directly with this rule. First, it does not treat the transfer as if it never happened. To the contrary, under section 3728, the transfer has important

consequences, burdening the trust or former owner. Second, under section 3728 the transfer is not void, as *Schwartz* held with respect to transfers under the automatic stay provision, but voidable. If no action is taken, the deed remains effective.

As the district court noted, section 3728 also conflicts with the Bankruptcy Code's system of ordering creditor's claims. If the tax lien is not paid in full within six months, then the tax purchaser takes the property free of all encumbrances under California Revenue and Taxation Code section 3712, whereas under the Bankruptcy Code all secured claims remain after bankruptcy proceedings are complete. 11 U.S.C. § 1129(b)(2); *see Lusardi,* 177 F. Supp. 2d at 1105.

The district court was therefore correct to hold California Revenue and Taxation Code section 3728 preempted.

Because of our preemption ruling, we do not reach the further issue raised by WSC that, regardless of federal law, section 3728 is not applicable in this case.

**Conclusion**

For the foregoing reasons the judgment of the district court is AFFIRMED.

40235 Washington Street Corp., Plaintiff, v. W.C. Lusardi, Defendant. AND RELATED COUNTERCLAIM

Case Number: 3:90-CV-01472

**UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA**

77 F.Supp.2d 1090

October 10, 2001, Decided
October 11, 2001, Entered

John S. Rhoades, Sr., United States District Judge.

Corrected Order Granting Washington Street's Motion for Declaratory Relief and to Quiet Title; and Denying Lusardi's Motion for Reimbursement under California Revenue & Taxation Code § 3728

## COUNSEL

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For W C LUSARDI, defendant: James A Testa, Testa and Associates, Vista, California

For W C LUSARDI, defendant: L Scott Keehn, Robins and Keehn, San Diego, California

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## OPINION

### I. Overview

Since 1990, Washington Street and Lusardi have litigated title to an apartment complex in Riverside County, California. They are before the Court on two

motions: (1) Washington Street's motion to dismiss, as a matter of law, Lusardi's claim to be a good faith purchaser under 11 U.S.C. § 549(c); (2) Lusardi's motion for reimbursement under California Revenue and Taxation Code § 3728. For the reasons stated below, the Court grants Washington Street's motion to dismiss and denies Lusardi's motion for reimbursement.

## II. Background[1]

Washington Street was created on February 20, 1990. Eight days later, it purchased an apartment complex (the Sun Dunnes) located on tax-defaulted property. At that time, the Sun Dunnes had two liens on it: a $447,000 tax lien along with a $277,000 first mortgage. The following day, Washington Street filed a Chapter 11 bankruptcy petition. Despite receiving a faxed copy of the bankruptcy petition, a week later, the Riverside County tax collector sold the Sun Dunnes at a tax foreclosure sale to Lusardi for $269,500. Lusardi was unaware of the petition.

After tax sale, the bankruptcy court, hearing Washington Street's Chapter 11 petition, dismissed it as being filed in bad faith. Specifically, the bankruptcy court found that Washington Street had no viable reorganization plan.

To date, Washington Street has not relinquished possession of the Sun Dunnes, and Riverside County has not returned Lusardi's money.

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[1] This abbreviated statement of facts is for context only. The Court's 8/19/98 Order contains a more detailed factual description.

From these simple facts, eleven years of legal wrangling ensued. In total, this case has seen one bankruptcy filing; two state court lawsuits; one state court appeal; one federal lawsuit; and two federal appeals.

In 1991, Washington Street sued Lusardi in this Court, arguing that the sale to Lusardi was void because it had occurred in violation of the automatic stay. *See* 11 U.S.C. § 362(a) (providing an automatic stay of attempts to gain possession of property if the owner has declared bankruptcy).

Lusardi moved to dismiss this case, arguing that the tax sale was only voidable, not void. In the alternative, Lusardi moved to stay the federal proceedings pending the outcome of the case he had filed in state court.

This Court agreed with Lusardi. Relying on the Ninth Circuit Bankruptcy Appellate Panel's decision in *In re Schwartz,* 119 B.R. 207 (9th Cir. BAP 1990), the Court held that the sale had not been voided. Accordingly, the Court dismissed Washington Street's case. In the alternative, the Court stayed the federal case while Lusardi's suit against Washington Street proceeded in state court.

Washington Street appealed the Court's rulings. While the appeal was pending, the Ninth Circuit overruled the Bankruptcy Appellate Panel's *Schwartz* decision, holding that violations of the automatic stay are void, not voidable. *See In re Schwartz,* 954 F.2d 569, 574 (9th Cir. 1992). Thus, this Court's dismissal of Washington Street's case was wrong. When the Ninth Circuit decided Washington Street's appeal, it vacated the dismissal order but affirmed the stay. *See 40235 Wash. St. Corp. v. Lusardi,* 976 F.2d 587 (9th Cir. 1992). The federal case then lay dormant for five years.

In 1996, the California Court of Appeals heard Lusardi's suit against Washington Street. The court, relying on the Ninth Circuit's *Schwartz* opinion, held that Lusardi's tax deed was void, not voidable.

In 1997, Lusardi returned to this Court, filing an answer and counterclaim to Washington Street's dormant federal case. In the counterclaim, Lusardi alleges that his purchase of the Sun Dunnes fell within 11 U.S.C. § 549(c), an exception to the automatic stay allowing certain good faith purchasers giving "present fair equivalent value" to keep real property purchased in violation of the automatic stay. In the alternative, Lusardi claims, under California Revenue and Taxation Code § 3728, that Washington Street must reimburse him money spent buying and then pursuing title to the Sun Dunnes. The Court granted Lusardi's motion to lift the stay, allowing the case to proceed.

## III. Discussion

The case raises two issues: one, whether Lusardi qualifies as a good faith purchaser under § 549(c); two, whether he is entitled to reimbursement under California Revenue and Taxation § 3728. On March 1, 2001, trial was scheduled to begin. Based on recent discovery, it became apparent that Lusardi would be unable, as a matter of law, to show that he paid "present fair equivalent value" as required by § 549(c). Accordingly, the Court orally granted Washington Street's Rule 50(a) motion to dismiss Lusardi's counterclaim.

After losing on § 549(c), Lusardi, echoing an earlier ruling by the Court (*see* 1/19/99 Order at 5-7), claimed that Washington Street must reimburse him the purchase price

of the property as required by § 3728. Otherwise, he continued, his tax deed could not be declared void for violating the automatic stay. Washington Street argued the opposite, that § 3728 did not apply. At a hearing held on April 23, 2001, the Court affirmed its earlier ruling – that § 3728 applied – and asked the parties to submit a cost accounting. After reconsidering the question, the Court decides that § 3728 is preempted by federal bankruptcy law and, therefore, inapplicable.

### A. Good Faith Purchaser Exception: 11 U.S.C. § 549(c)

Determining the holder of title to the Sun Dunnes depends on a two-step analysis. The first step is determining whether § 549(c) creates an exception to the automatic stay's void rule when the voided transfer was initiated by someone other than the debtor (in this case Riverside County). *See Schwartz,* 954 F.2d at 574 (holding that violations of the automatic stay are void). The second step is determining whether Lusardi meets the substantive requirements of § 549(c). If the answer to both questions is yes, then Lusardi's purchase of the Sun Dunnes is valid despite the automatic stay violation. Because, in a previous order, the Court held that § 549(c) is an exception to § 362(a) (*see* 1/19/99 Order at 9-12), an issue here is whether Lusardi satisfies § 549(c).

Title 11 United States Code, § 549(c), provides in pertinent part:

> The trustee may not avoid . . . a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or

> notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser.

**11 U.S.C. § 549(c)**. Essentially, § 549(c) creates a three-part test: (1) was Lusardi a "good faith purchaser without knowledge of the commencement of the case;" (2) did he pay "present fair equivalent value;" (3) did he perfect his tax deed before Washington Street recorded a copy or notice of the bankruptcy petition in Riverside County.[2]

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[2] Although not argued by Washington Street, Lusardi likely cannot satisfy this third condition. A § 549(c) purchaser must perfect (i.e., comply with the state recording statute) its interest before a copy or notice of the bankruptcy petition is recorded. In 1990, California was a "race-notice" state, *see* Cal. Civ. Code § 1214, meaning that Lusardi must have purchased his tax deed without knowledge of the bankruptcy petition (the "notice" element) and recorded it before Washington Street recorded a copy or notice of the bankruptcy petition in Riverside County (the "race" element). *See In re Walker*, 861 F.2d 597 (9th Cir. 1988).

Whether Lusardi purchased the property ignorant of Washington Street's bankruptcy petition is not at issue here. Thus, whether Lusardi satisfies § 549(c)'s perfection conditions turns on whether he recorded his tax deed before Washington Street recorded notice of the bankruptcy petition.

After the tax sale, Riverside County refused to deliver or record Lusardi's tax deed until Washington Street's bankruptcy petition was dismissed. Thus, presumably, Lusardi was unable to satisfy the "race" element because Washington Street filed a notice of the petition in Riverside County sometime between the tax foreclosure sale and the dismissal of the bankruptcy petition. (The Court must presume this because Washington Street offers no evidence that it recorded notice of its bankruptcy petition in Riverside County before Lusardi recorded his

(Continued on following page)

Lusardi carries the burden of proving all three conditions. *See* Fed.R.Bankr.P. 6001.

Determining "present fair equivalent value" requires a comparison between the price actually paid at the tax sale for the Sun Dunnes, $269,500, and its worth or "benchmark" value, $615,000 (the value set by Lusardi's expert, *see* Hess, 10/25/00 Appraisal Report, at 2, 4). *See BFP v. Resolution Trust Co.,* 511 U.S. 531, 540, 128 L. Ed. 2d 556 114 S. Ct. 1757 (1993); *In re Shaw,* 157 B.R. 151, 154 (9th Cir. BAP 1993). If the price paid is the "present fair equivalent" of the Sun Dunnes' benchmark value, then § 549(c)'s value condition is satisfied.

Here, there are two competing benchmarks: close-to-fair-market value; or the winning bid at a tax foreclosure sale properly conducted according to state foreclosure law. For two reasons, the Court finds that the proper

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deed. Somewhere, buried in the thousands of pages of briefs in this case, there may be such evidence. However, the Court has no intention of digging through the parties' papers "like pigs, hunting for truffles buried in briefs." *United States v. Dunkel,* 927 F.2d 955, 956 (7th Cir. 1991).)

Riverside County's refusal to give Lusardi the deed raises a novel question. Can Riverside County's refusal to turnover Lusardi's tax deed defeat his § 549(c) claim? The answer is yes, it can. Section 549(c) questions demand prompt resolution. *See In re Walker,* 861 F.2d at 600. Courts must be able to look quickly to county property rolls to see whether the § 549(c) purchaser has taken the necessary steps under state law to perfect its claims against any hypothetical subsequent bona fide purchaser. *See id.* citing *In re Ward,* 837 F.2d 124, 126-27 (3d Cir. 1988). Otherwise, courts would be required to make an ad hoc determination of respective rights of the § 549(c) purchaser versus other potential purchasers. *See id.* Such delay is inappropriate. Based on this policy consideration, if the Court were ruling on this question, it would hold that Lusardi fails § 549(c)'s perfection requirement.

benchmark value for § 549(c), in the context of a state conducted tax foreclosure sale, is something close to market value. First, close-to-fair-market value is consistent with the language of § 549(c) and the fundamental policies guiding interpretation of the Bankruptcy Code (the "Code"). Second, close-to-fair-market value is not inconsistent with the Supreme Court's holding and analysis in *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 128 L. Ed. 2d 556, 114 S. Ct. 1757 (1994).

### 1. Text of 11 U.S.C. § 549(c) and Bankruptcy Policy

To determine the appropriate benchmark, the Court looks first to the statute. *See BFP,* 511 U.S. at 537 (1994). Section 549(c) gives no definition of "present fair equivalent value." *See In re Shaw,* 157 B.R. at 153. Thus, as other courts have done, the Court will parse the three key terms in § 549(c): "present," "fair equivalent," and "value" to determine the appropriate benchmark. *See, e.g., In re Stone,* 72 F.3d 466 (5th Cir. 1995).

Looking first at "value," it sheds little light on determining the proper benchmark. Unlike other Code sections, *see, e.g.,* 11 U.S.C. § 548(d)(2)(A), § 549 contains no definition of value. Although appearing throughout the Code, "value" has no single meaning. *See BFP,* 511 U.S. at 551 n.1 (5-4 decision) (Souter, J, dissenting). In 11 U.S.C. § 522, it means "fair market value." *See* 11 U.S.C. § 522(a)(2). In 11 U.S.C. § 548, it can mean the price received at a foreclosure sale. *See BFP,* 511 U.S. at 545. Outside of the foreclosure sale context, it can mean something closer to fair market value. *See id.* In 11 U.S.C. § 506, the meaning of "value" varies with the purposes of

the valuation, which in turn varies with the particular Code provision to which the valuation pertains. *See* 4 L. King, *Collier on Bankruptcy* ¶ 506.03 (2001). Whatever benchmark § 549(c) requires, "value" is too malleable to provide much guidance.

Looking next at the term "fair equivalent," it too provides little guidance. It is akin to the term "reasonably equivalent" from 11 U.S.C. § 548. *See In re Stone,* 72 F.3d at 470 (5th Cir. 1995). Like § 549(c), § 548 requires a comparison between the price paid and the benchmark value. *See BFP,* 511 U.S. at 546. In *BFP,* the Supreme Court found "reasonably equivalent" ambiguous as to the proper § 548 benchmark. *See id.* at 537. Indeed, the *BFP* court used "fair" interchangeably with "reasonably," suggesting that these terms contain the same ambiguity. *See Stone,* 72 F.3d at 470-71 (citing *BFP,* 511 U.S. at 540, 545).

"Present" is more helpful. Traditionally, in bankruptcy law, "present value" means something other than the satisfaction of prepetition debt. *See, e.g., In re Major,* 218 B.R. 501, 505 (Bankr. W.D. Mo. 1998); *In re Briglevich,* 147 B.R. 1015, 1021 (Bankr. N.D. Ga. 1992); *In re Purnell,* 92 B.R. 625, 630 (Bankr. E.D. Pa. 1988); *In re Wilson,* 52 B.R. 637, 638 (Bankr. E.D. Tenn. 1985). According to this understanding, if proceeds of a transaction are used to satisfy antecedent debt, these proceeds cannot be used to calculate "present value." *See id.*

In the foreclosure context, the use of "present" shows that the proper § 549(c) benchmark should not be the winning bid at a foreclosure sale. Sometimes, the proceeds from foreclosure sales are less than the amount needed to satisfy the mortgage, creating a "deficiency." *See generally,*

4 M. Wolf, *Powell on Real Property,* ¶ 37.41 (2000). Thus, with a "deficiency," if the § 549(c) benchmark is simply the winning bid at a foreclosure sale, then no "fair equivalent value" is given for the property.

This result is absurd. It suggests that "fair equivalent value" can be satisfied when zero value has been given. Whatever § 549(c) requires, it must require something.

The other benchmark option – close-to-fair-market value – avoids this absurdity while garnering substantial support from two core principles of the Code. One core principle is that exceptions to the automatic stay are read narrowly. *See Far Out Prod., Inc. v. Oskar,* 247 F.3d 986, 995 (9th Cir. 2001) (noting the existence of narrow equitable exceptions to the automatic stay); *Hillis Motors, Inc. v. Hawaii Auto. Dealers' Assoc.,* 997 F.2d 581, 590 (9th Cir. 1993) (noting that "exceptions to the automatic stay should be read narrowly"). A narrow reading gives debtors greater protection from creditors, thus "alleviating financial strains on debtor[s]." *In re Del Mission Ltd.,* 98 F.3d 1147, 1151 (9th Cir. 1996). If giving no value can satisfy § 549(c), then this exception is no longer narrow.

A second core principle is treating creditors equally. *See In re Glasply Marine Indus.,* 971 F.2d 391, 394-95 (9th Cir. 1992). Section 549 applies to postpetition transactions, meaning transactions occurring after the filing of the bankruptcy petition. The filing of the petition creates an important state of affairs. First, the debtor's property is collected and becomes property of the bankruptcy estate. *See Hillis,* 997 F.2d at 585. Second, creditors' claims are grouped and managed according to each creditor's relative priority. *See id.* at 585-86. In grouping creditors' claims, a key concern is equality of distribution. *See* H.R.Rep. 595,

95th Cong., 1st Sess. 178 (1997) (a "prime bankruptcy policy [is] equality of distribution among creditors of the debtor . . ."). However, if one creditor can satisfy § 549(c) by paying little or no value – a possible result when the § 549(c) benchmark is simply the winning bid at tax auction – then this creditor jumps the queue, taking property out of the estate that, otherwise, would remain for distribution to all creditors. *See In re Powers,* 88 B.R. 294, 297 (Bankr. D. Nev. 1988) (noting that because postpetition transfers take property from bankruptcy estate, the transferee must pay something close to fair market value).

By contrast, the close-to-fair-market benchmark honors these core principles. First, with a higher benchmark, fewer transfers will fit into the § 549(c) exception. Second, this benchmark treats creditors equally. Whatever property is taken out of the estate, something of approximately equal value is put back in. Consequently, no one creditor gains a windfall at the expense of others.

Thus, "present fair equivalent value" tolerates little deviation from fair market value. *See In re Shaw,* 157 B.R. at 154 (9th Cir. BAP 1993) (citing *In re Powers,* 88 B.R. at 296-97); *In re Glendenning,* 243 B.R. 629, 636 (Bankr. E.D. Pa. 2000); *In re Auxano Inc.,* 96 B.R. 957, 963 (Bankr. W.D. Mo. 1989). Here, Lusardi purchased the Sun Dunnes for 44% of fair market value ($269,500 divided by $615,000). Forty-four percent of fair market value is too low to be "present fair equivalent value." *See In re Shaw,* 157 B.R. at 154 (holding that 47% of fair market value is not "present fair equivalent value"); *In re Powers,* 88 B.R. at

297 (holding that 73% of fair market value is not "present fair equivalent value").[3] Accordingly, Lusardi did not pay "present fair equivalent value."

### 2. Interference with State Interests

Lusardi's tax deed is void for two reasons: one, Riverside County violated the automatic stay by selling the Sun Dunnes; two, Lusardi paid less than "present fair equivalent value." Usually, a tax foreclosure sale conducted according to state law (as in this case) cannot be undone because of price inadequacy, unless the sale price "'shock[s] the conscience.'" *BFP,* 511 U.S. at 542-43 (citations omitted). By voiding Lusardi's tax deed, an essential state interest is impinged, namely, the security of title to property acquired from foreclosure sales. *See id.* at 544. Lusardi's tax deed would not be void if § 549(c)'s benchmark were not interpreted as close-to-fair-market

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[3] Lusardi also claims that his purchase price of $269,500 is something close to fair market value. When sold, the Sun Dunnes had a tax debt of $474,000 and a first mortgage of $250,000. According to Lusardi's expert, because there was no equity in the property, no bidder would have paid anything close to $269,500. Thus, the $269,500 was significantly more than the Sun Dunnes' fair market value.

This argument fails as a matter of law for two reasons. First, with certain exceptions not applicable here, tax deeds come free and clear of all encumbrances. *See* Cal. Rev. & Tax. Code § 3712. So, Lusardi's experts' math is faulty: it assumes encumbrances not at issue in a tax foreclosure sale.

Second, "equity" means something different than "fair market." "Equity" is the difference between fair market and debt in property. *See* Black's Law Dictionary, 484 (5th ed. 1980). Thus, a purchase price exceeding the equity in the sold property is not the same as a payment exceeding the "fair market value" of property.

value. Because this interpretation affects an area of traditional state regulation, it must comply with the principle of comity. *See id.* at 543-44.

Comity is a principle of judicial federalism. *See* Laurence H. Tribe, *American Constitutional Law,* § 3-28 (1988). It requires courts to respect state sovereignty by minimizing the conflict between state and federal law. *See id.* When an interpretation of federal law disrupts areas of traditional state regulation, the disruption is permitted if the federal law manifests such an intent, either by stating so or by clear implication. *See BFP,* 511 U.S. at 543, 544, 546. Absent clear intent, federal bankruptcy law should be interpreted to adopt, rather than displace, preexisting state law. *See id.* at 545.

Relying on the principle of comity, the Supreme Court, in *BFP,* refused to interpret § 548's "reasonably equivalent value" to require a fair market benchmark. The Court reasoned in three steps. Initially, it concluded that "reasonably equivalent" was ambiguous about the proper benchmark. *See id.* at 537, 547.

Second, the Court found that significant state interests are upset if § 548's benchmark is fair market value. *See id.* at 540, 544. Specifically, according to *BFP,* a fair market benchmark presumes selling done without time pressure and subject to the normal give and take of negotiation. *See id.* at 538. These presumptions are the "very antithesis" of foreclosure sales: prices are not fixed by mutual negotiation; there is neither the time to find a suitable buyer nor mutual negotiation between them. *See id.* Consequently, "every piece of realty purchased at foreclosure would be under a federal cloud," because it would not be sold for fair market value, and so could be undone through § 548. *See id.* at 544.

Third, the *BFP* court determined that interpreting "reasonably fair equivalent" to require a fair market benchmark did not comply with the principle of comity. *See id.* at 540, 543, 544-45. "Reasonably fair equivalent" is an ambiguous term, *see id.* at 547, manifesting no clear intent to disrupt an "essential" state interest, namely security of title. *See id.* at 544. Therefore, the Court refused to interpret the benchmark as fair market.

Some courts have extended *BFP's* analysis to § 549(c). For example, in *In re T.F. Stone,* the court was "unable . . . to perceive a meaningful difference between 'reasonably [equivalent value]' and 'present fair [equivalent value]' as applied in the context of [a] forced-sale case." 72 F.3d at 470. Because § 549(c)'s language contained the same amount of ambiguity as § 548, and the disruption to state foreclosure law was the same as in *BFP,* the *Stone* court extended BFP's holding to § 549(c). *See id.* at 471-72.

Lusardi contends that *Stone* controls the § 549(c) analysis in this case. In *Stone,* as here, the bankruptcy provision at issue is § 549(c). As in *Stone,* Lusardi argues, the disruption to state foreclosure law is the same. The terms from § 549(c) supporting the close-to-fair-market benchmark – "present fair equivalent value" – are ambiguous as in *Stone.* Because they are ambiguous, Lusardi concludes, "present fair equivalent value" cannot justify the disruption to state foreclosure law. Instead, as in *Stone* and *BFP,* Lusardi continues, the benchmark should be the winning bid at a properly conducted foreclosure sale because it complements settled state foreclosure law.

The Court disagrees with Lusardi's argument, instead finding *Stone* inapplicable. In *Stone,* the tax sale at issue resulted from tax deficiencies arising postpetition. *See* 72

F.3d at 470. Here, Washington Street's tax debt arose prepetition. Thus, unlike here, in *Stone* there was no conflict between § 362(a) and § 549(c) that would justify a narrower reading of § 549(c). *See In re D'Alfonso,* 211 B.R. 508, 518 (Bankr. E.D. Penn. 1997). When § 362(a) and § 549(c) do conflict, courts interpret § 549(c) narrowly, finding that "present fair equivalent value" creates a tougher standard than § 548's "reasonably equivalent value." *See, e.g., Shaw,* 157 B.R. at 154; *In re Powers,* 88 B.R. at 296-97.

Furthermore, by extending *BFP,* the *Stone* court ignored *BFP's* narrowly crafted holding:

> We emphasize that our opinion today covers only mortgage foreclosures of real estate. The considerations bearing upon other foreclosures and forced sales (to satisfy tax liens, for example) may be different.

*BFP,* 511 U.S. at 537 n.3. Relying, in part, on this limiting language, the *In re D'Alfonso* court refused to follow *Stone. See* 211 B.R. at 518.

In the present case, two other "considerations" militate against extending BFP to § 549(c) cases. First, § 549(c) and § 548 contain different language. The § 549(c) benchmark is "present fair equivalent value," while the § 548 benchmark is "reasonably equivalent value." By using different terms, Congress is presumed to have acted purposefully and intentionally. *See BFP,* 511 U.S. at 537. Reflecting this different language, this Court presumes that Congress created a § 549(c) benchmark different from § 548. *See In re Samaniego,* 224 B.R. 154, 164 n. 5 (Bankr. E.D. Wash. 1998) (refusing to follow *Stone* because "these two clearly different terms" – "present fair equivalent

value" and "reasonably equivalent value" – create different standards); *Shaw,* 157 B.R. at 154 (§ 549(c) and § 548 use different benchmarks); *In re Powers,* 88 B.R. at 296-97 (same).

Second, the disruption of states' interests in § 549(c) is different than § 548. In § 548, the source of the disruption is § 548 itself. Section 548 authorizes the trustee to set aside prepetition transactions not for "reasonably equivalent value."

In contrast, § 549(c) is not the source of the disruption; § 362(a) is. Section 362(a)(4) enjoins creditors (including government units, *see* 11 U.S.C. §§ 101(15) and (27)) from enforcing liens. The automatic stay prohibits "all foreclosure actions." *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1978). Section 362(a)'s void rule, enunciated in *Schwartz,* sets aside the results of state foreclosure sales. *See Schwartz,* 954 F.2d at 575 (voiding tax assessment for violation of automatic stay). As an exception to § 362(a), § 549(c) creates no more interference than that already created by § 362(a). Accordingly, interpreting § 549(c) to require a close-to-fair-market benchmark yields no additional disruption to areas of state regulation. By creating no additional interference, § 549(c) raises none of the comity concerns found in *BFP.*

### B. Revenue & Taxation Code § 3728

Lusardi wants his $269,500 back. Under California Revenue and Taxation Code § 3728, before a tax deed is declared void, the former owner of the property, Washington Street, must pay the tax purchaser, Lusardi, the money spent to win the property at auction, $269,500,

along with other costs and penalties "expended . . . in pursuit of title." Cal. Rev. & Tax. Code § 3728.

In its January 1999 Order and at the April 23 hearing, the Court held that § 3728 applies to this case. During the April 23 hearing, the Court ordered the parties to submit a cost accounting to determine what Washington Street owed Lusardi under § 3728. Finding § 3728 applicable was wrong. Section 3728 does not apply to this case; it is preempted by federal bankruptcy law, because it interferes with how the Code handles prepetition debts.

### 1. Applicability of California Revenue & Taxation Code § 3728

Under the Supremacy Clause, federal law is the supreme law of the land. U.S. Const., Art. VI, cl. 2. As a consequence, laws interfering with, or contrary to, federal law are preempted. *See Perez v. Campbell,* 402 U.S. 637, 652, 29 L. Ed. 2d 233, 91 S. Ct. 1704 (1971). The Supreme Court has recognized three kinds of preemption: (1) "express preemption," where federal law orders that the state law be displaced, *see Morales v. Trans World Airlines, Inc.,* 504 U.S. 374, 119 L. Ed. 2d 157 112 S. Ct. 2031 (1992); (2) "field preemption," where federal law "so thoroughly occupies a legislative field as to make reasonable the inference that Congress left no room for the States to supplement it," *Cipollone v. Liggett Group, Inc.,* 505 U.S. 504, 516, 120 L. Ed. 2d 407, 112 S. Ct. 2608 (1992) (citation omitted); and, (3) "conflict preemption," when compliance with both federal and state regulations is physically impossible or when state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress, *see Gade v. National*

*Solid Wastes Management Association,* 505 U.S. 88, 98, 120 L. Ed. 2d 73, 112 S. Ct. 2374 (1992) (citations omitted).

Express and field preemption are not at issue here. The Code has no explicit preemptive language applicable to state foreclosure law. Nor is the Code's regulation so pervasive as to crowd out state laws regulating property tax collection.

When analyzing conflict preemption, the task – as in all preemption analysis – is to determine whether state regulation is consistent with the structure and purpose of the federal statute as a whole. *See Gade,* 505 U.S. at 98. Making this determination requires a two-step analysis: first, construe the two statutes at issue; second, determine whether they conflict sufficiently to warrant preemption. *See Perez,* 402 U.S. at 644. A sufficient conflict occurs when the state law has a direct and substantial impact on the federal scheme. *See Gade,* 505 U.S. at 107 (citation omitted).

### a. California Revenue & Taxation Code § 3728

In California, before a tax deed is declared void, § 3728 requires a settling of the accounts.[4] Section 3728

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[4] Section 3728 provides, in relevant part:

> Before holding any tax deed . . . to be void, the court shall determine the correct amount of taxes, penalties, and costs that should be paid upon redemption to discharge the tax and assessment liens of all taxing agencies and revenue districts had the purported tax sale not been held and the court shall order the former owner . . . to pay that amount within six months as follows:

(Continued on following page)

requires courts to settle the accounts by a three-step process. *See* Cal. Rev. & Tax. Code § 3728. First, the court determines the amount of taxes owed before the sale. *Id.* Next, from this total, the court orders the former owner to pay the tax purchaser that portion of the taxes, penalties, and costs that the latter "expended . . . in pursuit of title." *Id.* In effect, this means that when the purchase price is less than the taxes owed, the former owner must pay the tax purchaser the purchase price, because the taxing authority will have applied the proceeds of the tax sale to reduce the tax debt owed on the property. *See* Cal. Rev. & Tax. Code §§ 3717.5, 3718, 3719. Third, the court orders the former owner to pay the remaining taxes owed to the proper tax agencies. *See* Cal. Rev. & Tax. Code § 3728. The former owner must make both payments within six months of the deed being declared void. *See id.* Otherwise, the court will issue the tax purchaser a new tax deed. *See* Cal. Rev. & Tax Code § 3728.1.

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> (a) To the purchaser . . . the amount of taxes, penalties and costs expended by him or her as determined by the court in pursuit of title to the property, and when the purchaser at that sale . . . in good faith and claiming the property under a tax deed, which is regular upon its face, and has made permanent improvements thereon, the court shall not make that decree until there has also been repaid to the purchaser . . . a sum, as determined by the court, equal to the amount by which the value of the property has been enhanced by those permanent improvements;. . . .
>
> Cal. Rev. & Tax Code § 3728.

**b. Violation of 11 U.S.C. § 362(a)**

Violations of § 362(a) are void, meaning they accomplish nothing. *See Schwartz,* 954 F.2d at 572-73. The purpose of the automatic stay is to protect debtors from creditors and preserve the status quo so that the debtors' property can be organized pursuant to bankruptcy law and process. *See Hillis,* 997 F.2d at 586.

The void rule furthers this purpose in several ways. One, it ensures that debtors need not take any action to protect themselves from creditors' collection efforts. *See Schwartz,* 954 F.2d at 571. Two, it imposes on creditors (and in this case on Lusardi), rather than debtors, the burden of persuading a court that a transfer violating the automatic stay should not be voided. *See id.* at 572; *In re Soares,* 107 F.3d 969, 976 (1st Cir. 1997). Three, it negates any transfers of debtor property, thus maximizing the size of the estate for distribution to creditors. *See Soares,* 107 F.3d at 975.

The effectiveness of the automatic stay is "central to the functioning of the bankruptcy system." *See Far Out Productions, Inc. v. Oskar,* 247 F.3d 986, 995 (9th Cir. 2001). By preserving the estate, it allows creditors' claims to be ordered according to bankruptcy law. *See Hillis,* 997 F.2d at 586. To ensure its effectiveness, exceptions to the automatic stay are read narrowly. *See id.* at 590.

Preemption analysis requires an examination of how the state law at issue affects the structure of the federal scheme as a whole. *See Gade,* 505 U.S. at 98. Thus, how § 3728 affects the Code's management of tax liens, as a whole, must be construed as well.

The Code intricately manages property tax liens. As a lien on real property, the tax debt is secured. In Chapter 11 cases, it passes through the bankruptcy process, remaining a claim on the debtor's property. *See* 11 U.S.C. § 506(d); H.R. Rept. No 95-595, 95th Cong., 1st Sess. 356, 357 (noting that 506(d) permits liens to pass through the bankruptcy case unaffected); *see also, In re DeMarah,* 62 F.3d 1248, 1251 (9th Cir. 1995) (noting that property exempt from the bankruptcy estate nonetheless remains subject to a tax lien). When the amount of debt secured by the tax lien exceeds the value of the real property, Chapter 11 trustees can bifurcate the tax lien into secured and unsecured portions, relegating the unsecured portion to an eighth priority unsecured claim. *See In re Dever,* 164 B.R. 132, 145 (Bankr. C.D. Cal. 1994) (permitting "lien stripping" of IRS lien in a Chapter 11 case). Upon confirmation of the Chapter 11 plan, the taxing authority receives payment of the tax debt according to the reorganization plan, even if the taxing authority is impaired by and does not agree to the plan. *See* 11 U.S.C. § 1141(a); *see generally,* 4 L. King, *Collier on Bankruptcy,* ¶ 506.03[7][d][I] (2001). If the Chapter 11 plan is converted into a Chapter 7 liquidation, then, under § 724(b), proceeds from the sale of the property securing the tax lien become a fund to pay priority and administrative claims before the tax lien. *See* 11 U.S.C. § 724(b); *see also, In re Sherrill,* 78 B.R. 804, 807 (Bankr. W.D. Tex. 1987). The subsequent discharge of the debtor's tax obligation is binding on state tax agencies "despite the [s]tate's election not to share in the recovery of the bankruptcy estates' assets." *In re Ellett,* 254 F.3d 1135, 1141 (9th Cir. 2001).

### c. Conflict between § 3728 and the Code

The conflict between § 3728 and the Code arises in three ways. First, § 3728 conflicts with the meaning of the void rule in bankruptcy. Violations of the automatic stay are void for all purposes. Their ineffectiveness is permanent, not temporary. *See Anglemyer v. United States,* 115 B.R. 510 (D.Md. 1990) (tax assessment violating the automatic stay was invalid for every purpose even after the stay expired); *Richard v. City of Chicago,* 80 B.R. 451, 454 (N.D. Ill. 1987) (noting that dismissal of a case does not annul the effect of the stay voiding acts that violate it). The violations remain ineffective even if the underlying bankruptcy case is dismissed. *See In re Lampkin,* 116 B.R. 450, 453 (Bankr. D. Md. 1990). When exceptions to the void rule are allowed, they are narrowly tailored. *See Hillis,* 997 F.2d at 590.

Section 3728, on the other hand, conditions the "voiding" of a tax deed on the debtor paying off, in full, property taxes owed to the state taxing authority. Essentially, § 3728 creates another exception to the void rule for certain real property sold at a tax foreclosure sale. If its requirements are not met, then the tax purchaser receives a new tax deed on the property despite the tax deed being void. *See* Cal. Rev. & Tax Code § 3728.1.

By creating another exception to the void rule, § 3728 conflicts with the Code's treatment of void transactions. Under the Code, void transactions are treated as if they never occurred. *See Ellis v. Consolidated Diesel Electric Corp.,* 894 F.2d 371, 373 (10th Cir. 1990) (because results of judicial proceedings conducted in violation of the automatic stay were void, there was no final judgment upon

which the appellate court could base its jurisdiction) (cited with approval in *In re Schwartz,* 954 F.2d at 572); *see also, In re Sanders,* 198 B.R. 326, 329 (Bankr. S.D. Cal. 1996) (finding preempted a California law permitting postpetition foreclosure sale to relate back to a time before it occurred to make it valid). In contrast, § 3728 permits the holder of a tax deed – void under the Code – to nonetheless retain title.

Second, § 3728 conflicts with bankruptcy policies supporting the void rule. The void rule enables debtors to rely on the automatic stay to protect their property. *See Schwartz,* 954 F.2d at 571. Yet, as an exception, § 3728 undermines this protection. It obliges debtors to take affirmative steps to defend their property from state foreclosure sales when, as here, the state proceeds with the tax sale despite knowing of the automatic stay. Once the debtor's property is sold, according to § 3728, the debtor can recover the property after reimbursing the tax purchaser and paying the taxing authority the remaining taxes. *See* Cal. Rev. & Tax Code § 3728. Otherwise, the property is lost to the tax sale purchaser. *See* Cal. Rev. & Tax Code § 3728.1. To avoid this result, debtors must keep the property from being sold; merely notifying the taxing authority may be not be enough (as in this case). If § 3728 is not preempted, then debtors such as Washington Street must do what the *Schwartz* court said they shouldn't have to do: spend "a considerable amount of time and money policing and litigating creditor actions" when, as here, that creditor is a local tax agency. *Schwartz,* 954 F.2d at 571.

Third, § 3728 conflicts with the larger Code scheme for ordering creditors' claims. Under § 3728, the tax lien must be paid within six months. *See* Cal. Rev. & Tax Code § 3728. Otherwise, the tax purchaser gets the property

free of all encumbrances. *See* Cal. Rev. & Tax Code § 3712. Other secured claims (such as, here, the holder of the $225,000 first mortgage on the Sun Dunnes) are extinguished. *See id.* By contrast, in Chapter 11 cases such as this one, all secured claims pass through bankruptcy and remain claims on the property. *See* 11 U.S.C. § 1129(b)(2); *see generally,* 4 L. King, *Collier on Bankruptcy,* ¶ 506.03[7][d][I] (2001). They must be paid in full. *See id.* Otherwise, the reorganization plan cannot be confirmed. *See id.* Also, in Chapter 7 cases, tax liens are paid after other expenses. *See* 11 U.S.C. § 724(b); under § 3728, tax liens are paid first, or the property cannot be recovered.

The conflict between § 3728 and the Code is significant. It creates another exception to the void rule, an exception at odds with the purposes of the automatic stay. By elevating the claims of tax purchasers, § 3728 upsets the equal treatment of all creditors. Also, by giving the tax purchaser title free and clear of other secured claims, § 3728 conflicts with how the Code treats other secured creditors. Accordingly, § 3728 is preempted.

### 2. Analysis of Costs under § 3728

Should an appellate court disagree that § 3728 is preempted, the Court determines the money Washington Street owes Lusardi as follows:[5]

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[5] The Court realizes this determination is dicta. *However,* by these rulings, the Court hopes to avoid having the case remanded again. Or, if remanded, remanded with clear directions about how to proceed.

### a. Washington Street's Claim for Tax Reassessment

Section 3728 requires courts to determine the "correct" amount of taxes owed on the tax defaulted property. Here, when sold, the Sun Dunnes had a property tax bill of approximately $477,000. Washington Street claims that this assessment was wrong because Riverside County taxed it as a timeshare, instead of as an apartment complex. As an apartment complex, according to Washington Street, the Sun Dunnes' "correct" tax bill was $113,000.

There is a presumption that property taxes have been properly assessed. *See Plaza Hollister Limited Partnership v. County of San Benito,* 72 Cal.App.4th 1, 84 Cal. Rptr. 2d 715, 733-36 (1999). Before judicially challenging an assessment, the taxpayer must first exhaust all administrative remedies by appealing to the county equalization board. *See id.; see also, Sea World Inc. v. County of San Diego,* 27 Cal.App.4th 1390; (1994). After exhaustion, a court is permitted to examine the assessment method to determine if it is reasonable. *See May Dept. Stores Co. v. County of Los Angeles,* 196 Cal.App.3d 755, 771-72 (1987). If there is a reduction, it is appropriate only for subsequent years; the taxpayer is not entitled to a refund for past years. *See Sea World,* 33 Cal. Rptr. 2d at 200-01.

Given this standard, it is unclear whether the Court can entertain a challenge to the tax assessment in the first place. Nothing in Washington Street's papers shows that it exhausted its administrative remedies.

Assuming, *arguendo,* that it can entertain such a challenge, Washington Street's argument fails for lack of evidence. Washington Street relies on Riverside County's subsequent reduction in the tax rate assessed against the

Sun Dunnes. Although Riverside County subsequently lowered the Sun Dunnes' tax rate after the foreclosure sale, this reduction could reflect Washington Street's different plans for the Sun Dunnes – as an apartment complex versus as a timeshare – rather than Riverside County correcting an error. Yet a potentially new purpose cannot change the taxes that were owed when the property was being assessed as a timeshare before the tax sale. Nor can a new assessment require a retroactive refund of taxes based on correction of assessment errors. *See Sea World,* 33 Cal. Rptr. 2d at 201-02. Thus, Washington Street's motion for a "correct" reassessment is denied.

**b. Lusardi's Claim for Attorneys' Fees**

Lusardi asks the Court to award him attorneys' fees because they were costs incurred "in pursuit of title" to the Sun Dunnes. Attorneys' fees are not included within the term "costs." Unless attorneys' fees are "specifically provided for by statute," they may be required only by agreement of the parties. *See* Cal. Code Civ. Procedure § 1021. When, as in § 3728, the term "costs" is used alone, "[i]t is too well established to require citation of authority that 'costs' do not include attorneys' fees." *Downer Corp. v. Union Paving Co.,* 172 Cal. App. 2d 126, 129, 342 P.2d 64 (1959). Rather, each party must pay for its own legal fees. *See Trope v. Katz,* 11 Cal.4th 274, 278, 902 P.2d 259 (1995). Accordingly, Lusardi's request is denied.

**c. Lusardi's Insurance Costs and Interest**

Lusardi seeks reimbursement for prejudgment interest of $210,951 and for property insurance expenditures of

$6,358. Both requests are denied. Purchasers of tax-defaulted property from a public entity are limited to the remedies provided by the Revenue and Taxation Code. *See Van Petten v. County of San Diego,* 38 Cal. App. 4th 43, 47, 50 (1995). Unless provided by statute or contract, there is no right to prejudgment interest. *See Ball v. County of Los Angeles,* 82 Cal.App.3d 312 (1979). Here, § 3728 makes no mention of prejudgment interest or insurance premiums. *Compare* Rev. & Tax Code § 3728 *with* Rev. & Tax Code §§ 5151 (expressly providing for interest) *and* 5153 (same). Accordingly, Lusardi's request is denied.

### d. Lusardi's Purchase Price

Lusardi paid Riverside County $ 269,500 for the Sun Dunnes. He also paid $269.45 in costs for conducting the sale. Lusardi may recover these two amounts only under § 3728.

## IV. Conclusion

This case has been around a long time . . . too long! The tortured factual and procedural history began on February 20, 1990. For the next eleven years, the parties fought an unrelenting battle over two primary issues: one, whether the automatic stay voids Lusardi's purchase of the Sun Dunnes; and, two, whether the Code gives Lusardi a form of equitable relief as a good faith purchaser without notice of the automatic stay.

Like the proverbial slow boat to China, the case has meandered back and forth and up and down through the state and federal courts. New issues, like mussels on a slow moving vessel, were added, mutations and variations

of the issues were raised, argued and decided and sometimes redecided. Reams of paper were filed. Legions of lawyers, judges, law clerks and clerical workers spent countless hours trying to end a seemingly endless voyage. Endless hearings have been held. Opinions and orders have been written. Repeated appeals have been made. And for all of this time, effort and money, what do we have? The battle goes on. The costs go on and the parties don't even seem to be winded.

The case cries for an end, for a final determination of the rights and duties of the parties. The case is another Jarndyce and Jarndyce, droning on, a "scarecrow of a suit [that] in the course of time, has become so complicated that no man alive knows what it means." Charles Dickens, *Bleak House* 4 (Oxford University Press 1970) (1853). It is hoped, and the hope may be overly optimistic, that this opinion, and the opinion certain to follow from the inevitable appeal, will prevent the return of this case once again, like Banquo's ghost, to haunt the district court. As they say in New York, "enough already."

For the reasons stated above, the Court finds, as a matter of law, that Lusardi's purchase of the Sun Dunnes falls outside of § 549(c)'s exception to the automatic stay because Lusardi did not pay "present fair equivalent value." Also, the Court denies Lusardi's motion for reimbursement because § 3728 is preempted by federal bankruptcy law. If the preemption analysis is wrong, then Lusardi may recover his purchase price ($269,500) plus costs paid for conducting the sale ($269.45).

IT IS SO ORDERED:

Date: 10/10/2001

John S. Rhoades, Sr.
United States District Judge

**UNITED STATES COURT OF APPEALS**

**FOR THE NINTH CIRCUIT**

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| 40235 WASHINGTON STREET CORPORATION, a California corporation,<br><br>Plaintiff-Appellee,<br><br>v.<br><br>W.C. LUSARDI, an individual,<br><br>Defendant-Appellant. | No. 01-56644<br><br>D.C. No. CV-90-01472-JSR<br><br>**ORDER**<br><br>(Filed July 9, 2003) |
| 40235 WASHINGTON STREET CORPORATION, a California corporation,<br><br>Plaintiff-Appellant,<br><br>v.<br><br>W.C. LUSARDI, an individual,<br><br>Defendant-Appellee. | No. 01-56801<br><br>D.C. No. CV-90-01472-JSR |

Before: PREGERSON, REINHARDT, and ARCHER[1]

Judges Pregerson and Reinhardt have voted to deny the petition for rehearing en banc, and Judge Archer so recommends. The full court has been advised of the petition for rehearing en banc, and no judge has requested a

[1] The Honorable Glenn L. Archer, Jr., Senior Circuit Judge, United States Court of Appeals for the Federal Circuit, sitting by designation.

vote on whether to rehear the matter en banc. Fed. R. App. P. *35*. The petition for rehearing en banc is denied.

**11 United States Code § 362. Automatic stay**

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 [15 USCS § 78eee(a)(3)], operates as a stay, applicable to all entities, of –

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

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**11 United States Code § 549. Postpetition transaction**

(a) Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate –

(1) that occurs after the commencement of the case; and

(2)(A) that is authorized only under section 303(f) or 542(c) o [sic] that is authorized only under section 303(f) or 542(c) of this title; or

(B) that is not authorized under this title [11 USCS §§ 101 et seq.] or by the court.

(b) In an involuntary case, the trustee may not avoid under subsection (a) of this section a transfer made after the commencement of such case but before the order for relief to the extent any value, including services, but not including satisfaction or securing of a debt that arose before the commencement of the case, is given after the commencement of the case in exchange for such transfer, notwithstanding any notice or knowledge of the case that the transferee has.

(c) The trustee may not avoid under subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value

unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.

(d) An action or proceeding under this section may not be commenced after the earlier of –

(1) two years after the date of the transfer sought to be avoided; or

(2) the time the case is closed or dismissed.